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The Malaysian Economy in 1996 and Prospects for 1997

The Malaysian Economy in 1996

An Overview

Following a period of rapid expansion in the last eight years, the Malaysian economy is estimated to expand at a more sustainable pace in 1996. Real Gross Domestic Product (GDP) is envisaged to register a slower growth of 8.2% in 1996 (1995:9.5%), with the rates of growth in all sectors expected to moderate from the high levels achieved in 1995. The main impetus to growth continues to come from the manufacturing sector, which is envisaged to record a double-digit growth, while the services and construction sectors are also envisaged to perform better than the national average growth. However, output growth of the primary sector is expected to be lacklustre, with the growth of the mining sector expected to decelerate. In line with the GDP growth, nominal Gross National Product (GNP) continues to increase by 13.1% to RM235.3 billion. Concomitant with the increase in GNP, the per capita income of the population is envisaged to rise by 10.5% to reach RM11,118. In terms of purchasing power parity, the per capita income is equivalent to US\$12,508, an increase of 10.4% from the 1995 level.

The nation's external payments position is also expected to improve in 1996. Although merchandise exports have been affected by lower exports of primary commodities and slower growth in the export of electronics-related products, its growth exceeds that of imports for the first time since 1993. Growth in merchandise imports has decelerated significantly as a result of slower expansion in domestic and external demand. Consequently, the merchandise account is envisaged to record a larger surplus. The increase in the merchandise account surplus is estimated

to more than offset the increase in the deficit in the services account of the balance of payments, thus enabling the current account to record a smaller deficit. In the capital account, the gross inflow of foreign direct investment is estimated to be more than sufficient to finance the current account deficit. However, due to the increase in net payments of its external loans by the Federal Government coupled with lower borrowings by the Non-Financial Public Enterprises (NFPEs) as well as increased reverse investment by Malaysian companies, the basic account of the balance of payments is expected to record a deficit of RM2.4 billion which is smaller than the RM2.5 billion deficit recorded in 1995.

The moderation in economic growth has been accompanied by a slower growth in consumption, leading to an improvement in national savings as a percentage of GNP. As investment is expected to decline marginally as a percentage of GNP, the nation's savings-investment gap is expected to narrow, thereby enabling the nation to reduce its dependence on foreign resources, especially external borrowings to finance the gap. The improvement in the nation's resource position is attributed to the smaller resource gap of the private sector, as more savings are mobilised from individuals through the Employees Provident Fund (EPF) as a result of the higher number of contributors and the recent one percentage point increase in the contribution rate by employees, as well as through the newly established Amanah Saham Wawasan 2020, and the corporate sector as a result of increased earnings. The Federal Government continues to generate operating surplus that is more than sufficient to finance its development expenditure in 1996. However, due to stronger increase in public sector investment especially by the NFPEs, the public sector is envisaged to record a small resource gap in 1996.

Nevertheless, as a result of a reduction in private sector resource gap, the nation's savings-investment gap is envisaged to narrow in 1996.

Sectoral Performance

Value-added in the **manufacturing sector** is expected to continue to expand, albeit at a slower rate of 12.8% (1995:14.5%). The moderation in the growth of manufacturing output is mainly attributed to the deceleration in the growth of the electronics industry which has been affected by higher level of inventory in the global market as a result of increased competition and slower growth in demand. Output of the domestic-oriented industries, however, is expected to remain robust with chemical products, non-metallic mineral and glass products and transport equipment industries envisaged to generate strong output growth. Given that the manufacturing sector is envisaged to continue to grow at a higher rate compared with the other sectors of the economy, its share to real GDP is expected to increase from 33.1% in 1995 to 34.5% in 1996, while its contribution to overall real growth in 1996 is estimated at 51.6% (1995: 48.5%).

The **construction sector** is expected to achieve a more moderate growth of 9% in 1996 after recording a high growth of 17.3% in 1995. With this growth, its contribution to the real GDP is estimated to stabilise at 4.5%. The slower growth reflects partly the lower level of new construction starts associated with public sector projects as new projects approved under the Seventh Malaysia Plan are generally envisaged to take off after the first year of the Plan period. The construction of higher-end residential properties and commercial buildings is envisaged to be somewhat affected by the impact of the monetary and fiscal measures introduced in October 1995 to contain asset inflation and excessive speculation in the property sector as well as the prospects of excess supply in these properties. Nevertheless, construction starts of low and medium-cost houses remain robust.

Output of the **agriculture sector** is expected to grow at a slightly higher rate of 1.6% (1995: 1.1%). Output of palm oil is envisaged to increase at a more moderate rate of 2.9 % while that of rubber is expected to continue to decline by 1.7%. The output of other major commodities, such as sawlogs and cocoa, is envisaged to continue to decline at somewhat lower rates. Overall, the

growth in the agriculture sector continues to be lacklustre and consequently, its share to GDP is envisaged to drop further to 12.7% in 1996 (1995: 13.5%).

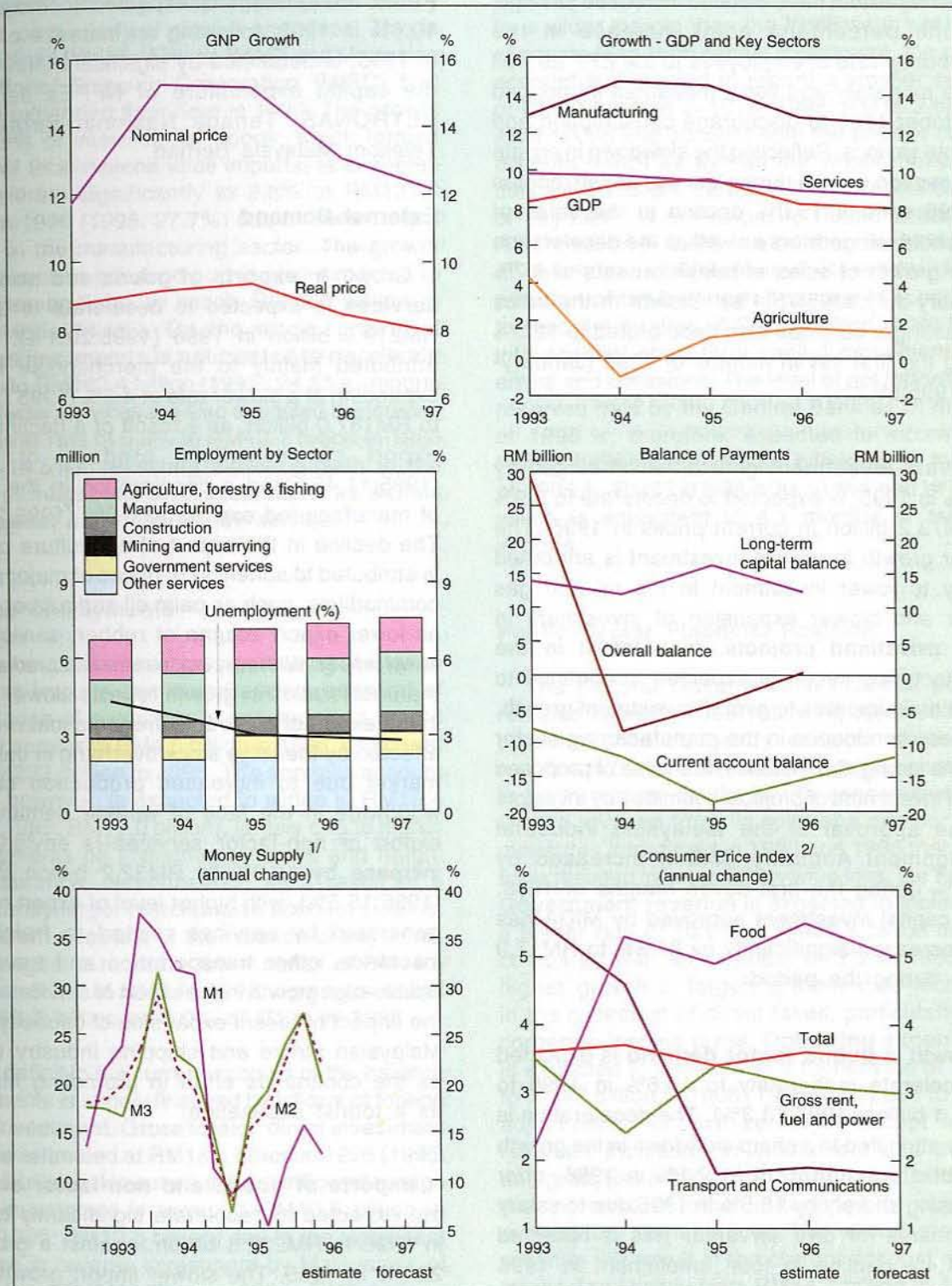
The growth of the **mining sector** is expected to decelerate to 3.1% in 1996(1995:9%), with the level of crude oil production maintaining at about the level in 1995 and the output of tin declining. Output of gas, however, is estimated to surge by 22.4%. With the overall slower output growth, the contribution of the mining sector to GDP declines to an estimated 7.1% in 1996 (1995:7.5%).

Value-added generated by the **services sector** is envisaged to expand at a slightly lower rate of 8.9% in 1996 (1995: 9.4%), increasing its share in GDP to 44.6% (1995:44.3%). The growth has been supported by increases in investment to modernise and enhance the capacity of the services sector in recent years, particularly in the transport, storage and communications sub-sector and the electricity, gas and water sub-sector which are expected to record double-digit growth, as well as strong demand for services, driven by higher disposable income. Robust growth is also estimated for the finance, insurance, real estate (including ownership of dwelling) and business services sub-sector in 1996. This is mainly attributed to strong credit expansion and expanded activities of the banking system and larger premiums collected from life and general insurance. The value-added of the wholesale and retail trade, hotels and restaurants sub-sector is also expected to remain strong, in view of rising disposable income and brisk tourist trade.

Domestic Demand

Aggregate domestic demand (including change in stocks) is envisaged to expand at a slower rate of 10.2% in current prices to RM250.1 billion in 1996, after a surge of 17.4% in 1995, due to slower growth in both private and public sector expenditure. Growth in **total private sector expenditure** is expected to decelerate to 10.1% in 1996 (1995: 18.7%), attributed to slower growth in both private consumption and investment expenditure. **Private consumption expenditure** is expected to register a relatively slower rate of growth of 10.6% to RM115.7 billion in 1996, compared with a growth of 13.1% at RM104.7

Chart 1.1
Key Economic Indicators



1/ End of March, June, September and December including Repos.
(except for 1996, which represents end of March, June and August)

2/ Malaysia (1994 - base year)

billion in 1995. The moderation in private consumption spending reflects the combined impact of lower earnings from primary commodities, firmer interest rates that have induced increased savings, the one percentage point increase in the contribution rate of employees to the EPF as well as the monetary and fiscal measures introduced in October 1995 to discourage consumption and promote savings. Reflecting the slowdown in private consumption growth during the first seven months of 1996 were a 15.0% decline in the sales of household refrigerators as well as the deceleration in the growth of sales of television sets to 1.7% (January-July, 1995:75.4%). Growth in the sales of passenger cars has also decelerated to 12.3% during the first seven months of 1996 (January-July, 1995:59.2%).

Private investment growth, which surged by 28.9% in 1995, is expected to decelerate to 9.9% or RM73.2 billion in current prices in 1996. The slower growth in private investment is attributed mainly to lower investment in the oil and gas sector and slower expansion of investment in large privatised projects. Investment in the manufacturing sector is expected to continue to be the main impetus to overall investment growth. Business confidence in the manufacturing sector remains strong. For instance, the value of proposed capital investment of projects submitted by investors for the approval of the Malaysian Industrial Development Authority (MIDA) increased by 115.6% during the first seven months of 1996. Total capital investment approved by MIDA has also increased significantly by 37.3% to RM17.9 billion during the period.

Growth in **public sector demand** is expected to decelerate moderately to 10.6% in 1996 to RM61.1 billion (1995:13.3%). The deceleration is largely attributed to a sharp slowdown in the growth of **public consumption** to 2.1% in 1996, after increasing sharply by 15.5% in 1995 due to salary adjustments for civil servants. This is reflected in a 1.4% decline in total emolument in 1996 compared with 11.1% growth recorded in 1995. Similarly, the expenditure on supplies and services is estimated to increase at a slower rate of 5.3%

in 1996, compared with a significant increase of 14.9% in 1995, reflecting the continued budgetary restraints and controls by the Federal Government. **Public investment** is expected to increase by 19.6% in 1996, following an increase of 11.4% in 1995, underpinned by significant increases in the capital expenditure of NFPEs especially PETRONAS, Tenaga Nasional Berhad and Telekom Malaysia Berhad.

External Demand

Growth in **exports of goods and non-factor services** is expected to decelerate to 5.0% to RM219.2 billion in 1996 (1995:20.1%). This is attributed mainly to the merchandise exports expanding at a slower rate of 4.2% (1995 : 20.9%) to RM187.0 billion, as a result of a decline in the export of agriculture produce of 15.3% (1995:11.4%) and a deceleration in the growth of manufactured exports to 5.8% (1995:22.9%). The decline in the export of agriculture produce is attributed to softening of prices of major primary commodities, such as palm oil and rubber as well as lower export volume of rubber, sawlogs and sawn timber. With respect to manufactured exports, the deceleration in growth reflects slower growth in the export of electronic products that has been affected by the large stock overhang in the global market due to increased production capacity worldwide in the face of weaker demand. The export of non-factor services is envisaged to increase by 10.2% to RM32.2 billion in 1996 (1995:15.5%), with higher level of export receipts generated by services related to freight and insurance, other transportation and travel. The double-digit growth in the export of services reflects the impact of recent expansion of capacity by the Malaysian airline and shipping industry as well as the continuous effort in promoting Malaysia as a tourist destination.

Imports of goods and non-factor services are expected to decelerate significantly to 2.6% in 1996 to RM222.5 billion, against a growth of 22.7% in 1995. The slower import growth is on account of a stronger ringgit especially against the yen as well as the moderation in the expansion of investment spending and manufactured output

which has affected the level of imports for capital and intermediate goods. Imports of capital goods are envisaged to decline by 6.9% to RM36.4 billion in 1996 (1995: 29.6%), reflecting partly lower lumpy imports, particularly of aircraft and ships. This is expected as Malaysia Airlines (MAS) and Malaysian International Shipping Corporation (MISC) had already expanded their fleet in 1995. The growth of imports of intermediate goods, which formed 66.3% of total merchandise imports, is expected to decelerate significantly to 3.8% to RM131.1 billion in 1996 (1995: 27.7%) due to lower output growth in the manufacturing sector. The growth of consumption goods import is also expected to be slower at 2.4% to reach RM12.3 billion in 1996 (1995: 14.1%). On the whole, growth of merchandise imports is anticipated to decelerate to 1.7% to RM182.4 billion (1995 : 24.5%). Imports of non-factor services are also expected to increase at a slower rate of 6.6% to RM40.1 billion in 1996 (1995: 14.5%), reflecting slower growth in the import of freight and insurance, travel as well as professional and consultancy services.

Balance of Payments

With merchandise exports increasing at a faster rate than imports, the **merchandise account** of the balance of payments is envisaged to record a larger surplus of RM4.6 billion in 1996, compared with RM233 million in 1995. The services account deficit, however, is expected to widen to RM19.4 billion (1995: RM19.0 billion), largely due to higher net payments on investment income and freight and insurance. Nevertheless, as a result of a significantly larger merchandise account surplus, the **current account** of the balance of payments is envisaged to record a lower deficit of RM14.8 billion or 6.3% of GNP in 1996, against a deficit of RM18.7 billion or 9.0% of GNP in 1995.

The deficit in the current account of the balance of payments is largely financed by inflows of foreign direct investment. Gross foreign direct investment inflow is estimated at RM18.1 billion in 1996 (1995: RM16.8 billion). However, the net inflow of foreign direct investment is lower at RM10.8 billion in 1996 (1995: RM10.3 billion) due to the significant increase in reverse investment by Malaysians of 14.1% from RM6.4 billion in 1995 to RM7.3 billion in 1996. At the same time, net inflow of official long-term capital is envisaged to be lower, at RM1.6 billion compared with RM5.8 billion in 1995.

This is largely due to larger net payments of external debt by the Federal Government as well as reduced borrowing from abroad by the NFPEs. With net inflow of official long-term capital declining by a wider margin than the increase in net inflow of private long-term capital investment, the capital account is expected to record a smaller surplus of RM12.4 billion in 1996 (1995: RM16.2 billion). After taking into account both the smaller current account deficit as well as the smaller surplus in the capital account, the basic account of the balance of payments is envisaged to record a deficit of RM2.4 billion in 1996, the third consecutive year of deficit since 1994. Nevertheless, the **overall position of the balance of payments** is expected to record a surplus of RM1.2 billion, after taking into account short-term capital movements and errors and omissions. The level of net international reserves held by the Central Bank as at the end of 1996 is, therefore, expected to increase by RM1.2 billion from RM63.8 billion as at the end of 1995 to RM65.0 billion as at the end of 1996, which is equivalent to 4.1 months of retained imports.

Public Sector Financial Position

The Federal Government's financial position remains strong in 1996, following continued fiscal prudence and budgetary controls which have resulted in the overall financial position continuing to be in surplus for the fourth consecutive year. On the revenue front, in spite of a number of tax measures introduced in 1995 and 1996 that would have resulted in potential revenue loss, the **Federal Government revenue** is expected to increase at a higher rate of 10.9% to RM56.5 billion in 1996 compared with an increase of 3% in 1995. The higher growth is largely attributed to increases in the collection of direct taxes, particularly from corporate income taxes. **Operating expenditure** is expected to increase at a higher rate of 14.2% to RM42 billion in 1996 (1995: 4.3%) due to salary adjustments for civil servants. Except for the resultant increases in emolument and pension and gratuities arising from the salary adjustments, the increase in other categories of operating expenditure remains low. The strong growth in revenue will result in the current account surplus increasing slightly from RM14.4 billion in 1995 to RM14.7 billion in 1996. With respect to **development expenditure**, the increase has been kept low at 6.4% over the 1995 level at RM14.9

billion in 1996. Thus, the overall financial position of the Federal Government is envisaged to record a slightly smaller surplus of RM1.4 billion compared with RM1.9 billion in 1995.

The **consolidated financial position of the public sector** is expected to record an overall deficit in 1996, attributed to increases in operating expenditure of the Non-Financial Public Enterprises (NFPEs) and, to some extent, the Federal Government. The consolidated revenue of the general government is expected to increase by 10.4% to RM69.9 billion while the consolidated operating expenditure is expected to register a higher growth of 14.6%, increasing from RM42.3 billion in 1995 to RM48.4 billion in 1996. This is mainly due to the increase in the Federal Government operating expenditure. Hence, the general government's current surplus is envisaged to increase by 2.0% in 1996 to RM21.5 billion. The NFPEs as a whole are expected to register a lower operating surplus in 1996 due to larger operating expenditure. As a result, the public sector current surplus is expected to be lower at RM35.0 billion in 1996 compared with RM35.2 billion in 1995.

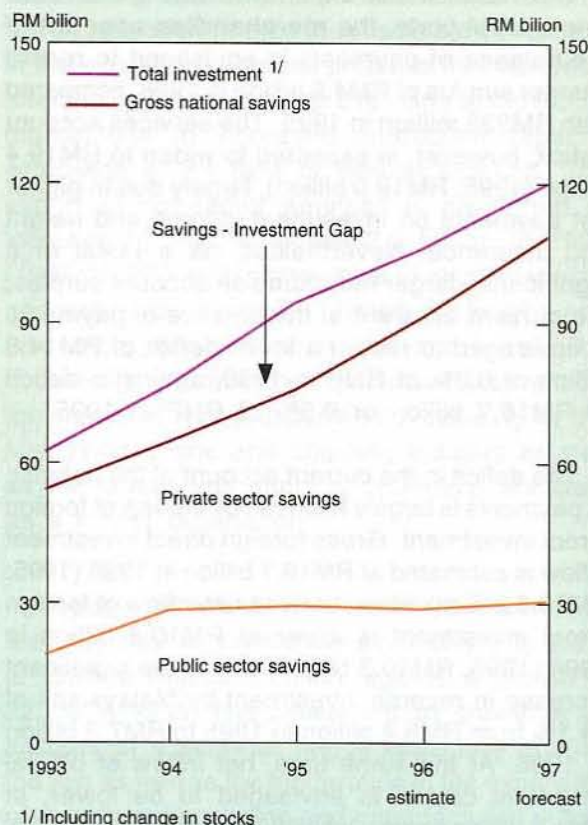
The development expenditure of NFPEs is estimated to increase further in 1996 by 30.3% to RM19.3 billion due to expansion and modernisation programmes of several NFPEs, mainly related to telecommunications and energy as well as the oil and gas sectors. With the public sector net development expenditure estimated to increase by 12.6%, the overall balance is envisaged to record a deficit of RM1.7 billion or 0.7% of GNP in 1996 compared with a surplus of RM2.6 billion or 1.2% of GNP in 1995.

National Resource Position

With total consumption expenditure envisaged to increase at a slower rate of 8.8% in current prices compared to the growth of GNP of 13.1%, the growth in gross national savings is expected to accelerate to 20.5% or RM91.4 billion in 1996 (1995: 17.2%). Consequently, the share of gross national savings as a percentage of GNP is expected to increase further to 38.8% in 1996,

from 36.5% in 1995. Of the total gross national savings, 35.5% is expected to be generated by the public sector and the balance 64.5% by the private sector. On the other hand, growth in investment is expected to decelerate to 12.3% or RM106.2 billion in 1996 (1995: 23.1%). As a percentage of GNP, investment is expected to decline marginally from 45.5% in 1995 to 45.1% in 1996. With the growth rate of savings envisaged to be faster than that of investment, the nation's resource position is expected to improve from a deficit of RM18.7 billion or 9.0% of GNP in 1995 to RM14.8 billion or 6.3% of GNP in 1996. The resource gap is largely attributed to the private sector which is envisaged to register a resource deficit equivalent to 6.1% of GNP, while the public sector is envisaged to record a small resource gap of 0.2% of GNP in 1996. The nation's resource gap is largely financed by the inflow of foreign direct capital, particularly into the manufacturing sector.

Chart 1.2
Savings - Investment Gap



Liquidity, Interest Rates and Foreign Exchange Rate

The banking system was flushed with liquidity during 1996, attributable to higher disposable income and inflows of foreign short-term capital to take advantage of interest differentials. Excess liquidity in the banking system amounted to RM2.4 billion at the end of August 1996 compared with RM1.5 billion at the end of 1995. This situation is associated with strong credit expansion by the banking system to the private sector. As a result, growth in money supply continues to significantly outpace the growth in output.

The excess liquidity in the economy has been actively managed by Bank Negara Malaysia (BNM) in order to ensure price stability and a sustainable pace of economic growth. This has been done mainly through a combination of direct and indirect instruments, including accepting deposits in the interbank market, centralising the excess funds of the Government and the Employees Provident Fund with BNM and the statutory reserve requirement (SRR). The SRR of banking institutions was raised twice, by one percentage point on 1 February 1996 from 11.5% to 12.5% and on 1 June 1996 from 12.5% to 13.5%, reflecting the continuing commitment of BNM in containing the rate of credit and monetary expansion, and hence, inflationary pressures. The SRR increases absorbed a total of RM5.4 billion. As a result, the growth of monetary aggregates M1, M2 and M3 decelerated from a peak of 17.0%, 27.9% and 27.0%, respectively at the end of April to 12.7%, 19.9% and 21.8% respectively, at the end of August. The measures to mop up liquidity has led to firmer domestic interest rates during the first eight months of 1996. The three-month interbank rate rose from 6.76% at the end of December 1995 to 7.28% at the end of August 1996 and fixed deposit rates and base lending rates offered by the banking institutions similarly rose during the period.

On the foreign exchange market, the ringgit strengthened against all currencies of Malaysia's major trading partners. During the first eight months of 1996, the ringgit strengthened 7.3% against the Japanese yen, 1.8% against the U.S. dollar

and 1.3% against the Singapore dollar, reflecting the confidence in the local currency as well as the fundamental strength of the economy.

Inflation

Containing price pressures continues to be given priority, particularly in an economy experiencing rapid expansion accompanied by rising domestic demand and supply constraints, particularly with regard to labour and food. Inflation, as measured by the rate of increase in the Consumer Price Index (CPI), remains relatively low, averaging 3.6% during the first nine months of 1996 (January-September 1995:3.4%). The slightly higher increase is due to upward pressures on food prices which recorded the highest rate of increase of 5.7% and contributed to 57.1% of the overall increase in the CPI during the period. The higher prices of food reflect mainly the impact of relatively strong increases in the CPI for fish which rose by 12.5% and rice, bread and cereals which rose by 6.9%. In contrast, the CPI for clothing and footwear registered a decline of 0.7% during the period. On a regional basis, the CPI for Peninsular Malaysia increased at a higher level of 3.9% compared with Sabah, 2.8% and Sarawak, 2.2%.

The achievement of the relatively low inflation has been largely the result of a combination of policy efforts to address and contain price pressures, in particular managing demand pressures, expanding supply as well as enhancing efficiency in the distribution system. These included the maintenance of fiscal prudence, tight monetary policy and the introduction of specific measures in October 1995 to increase savings, discourage consumption as well as enhance food supplies and reduce the cost of doing business, including the abolition and reduction of import duties on a wide range of goods. A firmer ringgit and abolition of duties on a host of imported essential items have also contributed to lowering the prices of imports. In addition, as Malaysia is an open economy with imported goods forming about 90% of GNP, lower prices of imports had contributed significantly to the easing of domestic price pressures. The Producer Price Index for imported goods has declined by 0.5% during the first eight months of 1996.

Labour Market

The labour market continues to be tight, as the pace of job creation continues to outpace the rate of expansion of the labour force. The demand for labour is expected to increase by 3.4% in 1996 while the growth of labour force is estimated at 3.2%. With an unemployment rate of 2.6%, the country continues to operate virtually under conditions of full employment. Although there were isolated cases of workers being laid off due to industrial restructuring, especially in the electronics sector, they were easily absorbed elsewhere. As the labour market continues to be tight, there has been upward pressure on wages. In the manufacturing sector, the average wage rose by 8.6% during the first seven months of 1996, while the increase in average sales per worker was 5.3%. As a result, the cost of labour per ringgit of sales in the manufacturing sector has increased to 6.31 sen per ringgit of sales during the first six months of 1996 from 6.12 sen per ringgit of sales during the corresponding period of 1995. However, the increase in the cost of labour per ringgit of sales during the period was not entirely attributed to higher average wage. Slower output growth and weaker sales price, particularly in the electronics sector as a result of conditions in the global market, have also led to higher labour cost per ringgit of sales.

Prospects for 1997

With world trade envisaged to expand by 7.2% and the economic performance of the industrialised countries expected to improve, the international trading environment would continue to be favourable for Malaysia in 1997. However, global competition for trade in goods and services is expected to intensify, as international trade is further liberalised under the World Trade Organisation and General Agreement on Trade in Services (GATS). The potential benefits which Malaysia can reap from the growth in world trade will depend on its capacity to compete in the global market. Studies have indicated that, to remain competitive, the manufacturing sector of the Malaysian economy has undertaken a strategic shift towards using more capital-intensive production technology in response to the tight labour market condition and to keep pace with technological advancements. The higher reinvestment allowance provided by the

Government since 1994 has intensified this shift. In view of this, it is envisaged that the export sector of the economy, especially the manufacturing sector, will continue to reap benefits from the expansion in world trade.

Given this external and domestic scenario, real GDP growth for 1997 is envisaged at 8.0%, marginally lower than the 8.2% growth estimated for 1996. The manufacturing sector, underpinned by capacity expansion and modernisation efforts, is expected to continue to provide the main impetus to economic and export growth. Export growth, driven mainly by manufactured exports, is expected to outpace the growth in imports which is expected to be moderate, consistent with the pace of domestic demand. Coupled with sustained efforts to develop the services sector into a vibrant foreign exchange generating industry, this will lead to further improvement in the current account position of the balance of payments. Similarly, the Federal Government's overall financial position is expected to improve, as fiscal policy will continue to focus on stringent controls on expenditure with the view to generating larger budgetary surpluses. Reflecting the impact of demand management through fiscal prudence and tight monetary policy as well as efforts to promote savings and discourage excessive consumption, inflation is expected to remain low. Containing inflation will remain one of the nation's primary objective in order to ensure that the higher income generated by economic growth is not eroded by higher consumer prices. With nominal GNP expected to increase by 12.0%, per capita income is expected to improve further by 9.5% to RM12,171 in 1997.

Sectoral Performance

The **manufacturing sector** is expected to continue to provide the main impetus to economic growth in 1997. Underpinned by the expansion in production capacity and projected favourable sales orders, the output of the manufacturing sector is expected to increase by 12.5%. The export-oriented industries that are expected to contribute significantly to this output expansion are the electrical and electronic products and rubber products. In the case of domestic-oriented industries, the non-metallic mineral products, the chemical and chemical products and the basic metal products are expected to provide the impetus to the sector's output growth. Based on the projects

that have been approved during 1995 and 1996 by MIDA, significant expansion of production capacity is expected in industries producing electrical and electronic products, chemical and chemical products, non-metallic mineral products and transport equipment. With the manufacturing sector continuing to expand at rate higher than those of other sectors, its share to GDP is envisaged to increase from 34.5% in 1996 to 36% in 1997.

Growth in the **construction sector** is forecast to decelerate to 8.8% in 1997 due to lower construction starts for office buildings, in view of potential excess supply, and higher-end residential properties which have experienced slower growth in demand, following measures introduced in October 1995 to curb excessive speculation and asset inflation. The impetus to growth in the construction sector is envisaged to come largely from acceleration in housing starts for the low- and medium-cost housing schemes as well as construction of factories in industrial sites. Ongoing construction of infrastructural projects such as the Kuala Lumpur International Airport and the Commonwealth Games Village are also projected to sustain the pace of activity in the construction sector during 1997.

Agriculture output growth is expected to remain low at 1.4%, slightly lower than the 1.6% growth envisaged for 1996. Rubber and sawlog production are expected to continue to decline while palm oil and cocoa output are expected to increase. The envisaged decline in rubber production is attributed to the further reduction in the matured hectareage mainly in Peninsular Malaysia, due to continued conversion of rubber land to other crops and for other uses. Higher production of palm oil is attributed to the maturity of an additional 106,000 hectares of oil palm, while the higher output of cocoa is the result of more rehabilitated hectareage coming into production. As for sawlogs, production will remain low in view of the Government's policy at achieving sustainable forest management.

The output of the **mining sector** is expected to increase by 0.9% in 1997. Gas production is expected to record an increase of 15.5%, while there will be a projected 2.1% decline in crude oil production and 1.6% decline in tin output. The lower crude oil production reflects the conscious effort to adhere to the National Depletion Policy as well as possible softening of crude oil prices,

as world production is envisaged to be in excess of consumption by some 50,000 barrels per day in 1997 due to higher output by non-OPEC members.

The growth of the **services sector** is expected to decelerate marginally by 0.2 percentage point to 8.7% in 1997, in tandem with the moderation in growth of the primary and secondary sectors of the economy. However, its growth will still be higher than the rate of expansion of the overall economy. Within the sector, the transport, storage and communications sub-sector is expected to continue to record double digit growth rate of 13%, reflecting capacity expansion following expansion programmes undertaken by the national airline and shipping lines as well as by the telecommunications companies. Similarly, the electricity, gas and water sub-sector is also projected to record a double-digit growth of 11.8%, in view of strong demand from residential, industrial and commercial users as well as additional generation capacity, particularly from the Independent Power Producers (IPPs). In contrast, the expansion in government services will continue to be at a moderately low level of 4%, consistent with the Government's continued efforts to consolidate and "right-size" the public sector. Overall, the share of the services sector to GDP is expected to increase from 44.6% in 1996 to 44.9% in 1997.

Domestic Demand

The expansion in domestic demand in 1997 is projected to decelerate slightly to 10.0% in nominal terms compared with 10.2% in 1996. The moderate pace of growth is largely on account of slower growth in public sector consumption and investment. Growth in private sector expenditure, however, is expected to be higher, with investment growing at a faster rate.

Private sector consumption is expected to expand at a slower rate of 9.3% in nominal terms in 1997 compared with 10.6% growth in 1996. Factors contributing to the slower growth include the relatively slower growth in disposable income and increases in savings, induced largely by the increase in workers' contribution rate to the EPF as announced in the 1996 Budget as well as vigorous efforts by the Government to promote savings.

Private sector capital outlay is expected to expand by 16.5% to RM85.3 billion. Continued business confidence, higher level of investment approved for the manufacturing sector in 1996 and recent incentives provided to the services sector are expected to provide the impetus for the private sector to increase investment. In the manufacturing sector, industries producing electrical and electronic products, chemical and chemical products, non-metallic mineral products and transport equipment are projected to record increases in their investment levels. In the case of the services sector, significant increases in investment are envisaged for the communications, utilities and the transportation sub-sectors. Other services sub-sectors that are likely to step up their investment are the banking, education and the business sub-sectors, with part of the capital outlay in information technology in congruence with the development of the Multimedia Super Corridor (MSC). With regard to the construction sector, investment relating to the construction of higher-priced residential properties is expected to moderate. Similarly, slower growth in investment in commercial buildings is envisaged in view of the potential excess supply of office space. Investment in the primary sector of the economy is not envisaged to accelerate, as output of the sector is generally expected to be lacklustre.

Growth in **public sector consumption** expenditure is envisaged at 0.9% to RM28.5 billion in 1997, lower than the 2.1% growth in 1996. The slower growth reflects the 4.2% decline in expenditure allocated for supplies and services. Nevertheless, emolument is envisaged to increase by 7.3%, particularly to meet the salary payments of additional staff in critical public sector services such as education and health. As a percentage of total public consumption, emolument accounts for 59.8%, while expenditure on supplies and services, 35.3%. The balance represents expenditure on administration and defence, which is envisaged to decline by 15.6% in 1997.

Public sector investment is anticipated to increase at a slower rate of 6.7% to RM35.1 billion in 1997, compared with 19.6% growth in 1996. Investment by NFPEs is expected to expand by only 0.1% to RM20.0 billion, undertaken mainly by PETRONAS, Tenaga Nasional Berhad and Telekom Malaysia Berhad. However, the Federal

Government's capital outlay is expected to increase by 30.0% to RM9.0 billion largely to finance the implementation of new projects approved under the Seventh Malaysian Plan. The bulk of the additional expenditure will be for the development of infrastructure and human resources.

External Demand

Exports of goods and non-factor services are projected to expand by 9.6% to RM240.2 billion in 1997, compared with 5.0% in 1996. Merchandise exports are expected to grow by 9.4% in 1997 (1996: 4.2%), attributable to higher rate of growth in manufactured exports. The export performance of manufactured goods is envisaged to continue to be strong, growing by 11.0% to RM173.2 billion in 1997 underpinned by strong growth in the export of electrical and electronic products. The share of manufactured exports to total exports is expected to reach an unprecedented 82.2% in 1997, from 81.0% in 1996. The export of agriculture commodities is expected to record a small increase of 1.1% to RM18.5 billion in 1997, mainly due to the increase in export earnings from palm oil and sawn timber. However, export receipts of other commodities are expected to decline, including rubber (-17.6%), palm kernel (-32.2%) and sawlogs (-8.1%). Export earnings of the mining sector are expected to decline by 3.7% to RM11.6 billion, after a rapid growth of 15.9% in 1996, mainly as a result of a 13.2% drop in earnings from crude petroleum. As a result, the share of major agriculture and mining exports to total export earnings is expected to decline to 14.3% or RM30.2 billion (1996: 15.8%). Exports of non-factor services are expected to grow by 10.9% to RM35.7 billion (1996: 10.2%) underpinned by a 9.9% increase in earnings from travel, particularly tourism, 11.2% from professional and consultancy services, 12.3% from transportation of passengers and related services and 9.4% from freight and insurance. This growth prospect is in line with Government efforts to support the initiatives of the services sector to develop the services sector into a vibrant foreign exchange generating industry as well to tap the export potentials in the global market.

Against a moderate expansion in domestic demand, **imports of goods and non-factor services** are projected to grow by 7.3% to RM238.7

billion in 1997. Merchandise imports are expected to increase by 6.7% to RM194.5 billion, with imports of capital goods expected to turn around positively due to increases in imports of capital goods by the manufacturing sector as well as the purchase of additional aircraft and ships as planned by MAS and MISC in 1997. Reflecting the impact of strong output growth of manufacturing sector and the efforts that have been made to strengthen inter-industrial linkages, the growth of imports of intermediate goods is envisaged at 6.8% in 1997. Imports of consumption goods are expected to increase at a slower rate of 2.1%, in line with a slower growth in disposable income as well as a higher rate of savings. The growth in imports of fee-based services such as freight, insurance, other transportation, consultancy and professional services is expected at 10.1% in 1997, partly due to the pick-up in external trade which will result in higher payments on freight and insurance and growth in domestic demand for services.

Balance of Payments

A significant improvement is envisaged for the **merchandise account** of the balance of payments in 1997, with the surplus projected to increase to RM10.0 billion. Merchandise exports are expected to increase by 9.4% to RM204.5 billion, while merchandise imports are expected to increase at a relatively slower rate of 6.7% to RM194.5 billion. Nevertheless, the deficit in the **services account** is expected to increase to RM21.6 billion in 1997, mainly due to increases in net payments on investment income, freight and insurance and consultancy and professional services. As a result, the **current account** of the balance of payments is expected to record a deficit of RM11.5 billion (4.4% of GNP) in 1997, which is significantly lower than the deficit recorded in 1996. The deficit in the current account is expected to be largely financed by higher inflows of foreign direct capital.

Public Sector Financial Position

The broad thrust of budgetary operations in 1997 will be aimed at achieving larger overall budgetary surplus through fiscal consolidation and continued restraint on consumption spending. In the allocation of development expenditure, priority will continue to be given towards the development of infrastructure and human resources as well as broadening and deepening the science and

technology base of the nation. As part of the efforts to consolidate expenditure, the Government will continue to expedite the process of privatisation of several government agencies and the NFPEs.

The Federal government financial position is projected to strengthen in 1997. Federal revenue before 1997 tax measures is projected to grow by 7.6% to RM60.8 billion. The increase is expected to emanate from both direct and indirect taxes. Operating expenditure is forecast to decline marginally by 0.2% to RM41.7 billion as the payment for arrears and higher salaries due to salary adjustments were already effected in 1996. Significant revenue performance amidst a small decline in operating expenditure is, therefore, expected to yield a substantially larger current account surplus of RM19.1 billion in 1997 (1996: RM14.7 billion). After taking into account loans recovery amounting to RM1,650 million, net development expenditure in 1997 is estimated at RM15.1 billion. Consequently, the overall balance is projected to show a larger surplus of RM3.9 billion or 1.5% of GNP (1996: RM1.4 billion or 0.6%).

The **consolidated public sector** overall balance is projected to improve in 1997. The current account balance of the consolidated public sector is anticipated to improve, attributable to larger current surpluses of both the general government and the NFPEs. Revenue of the general government is expected to increase by 4.9%, while operating expenditure is expected to decline by 2.5%. As a result, the general government's current account surplus is estimated to increase by 21.7% to RM26.2 billion compared with RM21.5 billion in 1996. Similarly, the major NFPEs are projected to maintain strong operating surpluses in 1997 amounting to RM18.0 billion compared with RM13.5 billion in 1996. Hence, the consolidated public sector current account is anticipated to register a larger surplus of RM44.2 billion in 1997 compared with RM35.0 billion in 1996.

Total public sector net development expenditure in 1997 is projected to increase by 7.6% to RM39.5 billion, attributable to the higher development expenditure of both the general government and the NFPEs. The increase in general government development expenditure is due to the larger Federal Government development expenditure to cater for projects committed under the Sixth Malaysian Plan as well as new projects under the Seventh Malaysia Plan. The NFPEs are expected

to spend substantial capital outlay on several major projects, such as the Kuala Lumpur International Airport and second Ethylene Cracker Project by PETRONAS. In view of the larger current account surplus, the consolidated public sector overall balance is projected to record a surplus of RM4.7 billion or 1.8% of GNP in 1997.

National Resource Position

The nation's resource position is expected to improve, as higher rate of savings is expected to be mobilised in 1997 through vigorous efforts to promote savings. A Cabinet Committee on the Promotion of Savings has been established to spearhead these efforts. Complemented by tight monetary policy to discourage excessive consumption and credit expansion, the availability of a wider choice of investment instruments for households and the larger budgetary surpluses of the Federal Government will contribute further to an increase in gross national savings by 19.1% to RM108.8 billion or 41.2% of GNP in 1997. With the level of gross capital formation expected to increase by 13.3% to RM120.3 billion or 45.6% of GNP, the national savings-investment gap is projected to further narrow to RM11.5 billion or 4.4% of GNP from 6.3% of GNP in 1996. This reflects mainly the improvement in public sector resource position from a deficit of 0.2% of GNP in 1996 to a surplus of 2.9% of GNP in 1997. As for the private sector, the resource gap is projected to widen to 7.3% of GNP in 1997, from 6.1% of GNP in 1996. This resource gap is envisaged to be largely financed from internally generated funds and inflow of foreign direct capital.

Inflation

Maintaining non-inflationary growth will remain the broad thrust of macroeconomic management in 1997. Consequently, developments in prices of consumer goods and services will be closely monitored while fiscal prudence and tight monetary policy will continue to be pursued to contain demand pressures. Nevertheless, with a more sustainable level of economic growth envisaged for 1997, low inflation in industrial countries, more vigorous efforts to promote national savings by the newly established Cabinet Committee on the Promotion

of Savings as well as the abolition of duties on essential consumer and intermediate goods, there would be further reduction in pressures on the price level.

Labour Market

The labour market is expected to remain tight in 1997. However, the dependence on unskilled and cheap foreign labour will continue to be discouraged as the size of foreign labour is already large. Industries will be required to lessen their dependence on cheap and unskilled foreign workers through strategic adjustments towards using a more efficient and labour-saving production technology. While the Government will continue to discourage the use of cheap and unskilled foreign workers, it will, however, continue to facilitate the recruitment of technically skilled and professionally trained foreign workers, in order to expedite the shift towards a more efficient production technology. At the same time, the training of local workers will continue to be encouraged with the view to generating a sufficient number of locally trained workers to meet the expanding needs of a fast growing economy.

Conclusion

The economy is envisaged to continue to record a more sustainable level of growth in 1997. The nation's resource position is envisaged to improve, with the level of domestic demand being more compatible with the level of national output. At the same time, the rate of national savings is envisaged to increase further. This will enable a significantly larger portion of domestic investment to be financed from national savings and thereby, reduce the need for the nation to resort to external funds for financing economic growth. The nation's balance of payments position is also expected to improve further in 1997, with the current account recording a smaller deficit. Inflation is expected to remain low as expansion of domestic demand for consumption goods and services is expected to be moderate. Thus, the fundamentals of the Malaysian economy are expected to strengthen further in 1997, with the economy maintaining a high level of sustainable growth against a background of low inflation and improved balance of payments position.